

**COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION**

IN THE MATTER OF APPLICATION     )  
OF KENTUCKY POWER COMPANY     )  
D/B/A AMERICAN ELECTRIC POWER     )  
FOR APPROVAL, TO THE EXTENT     )  
NECESSARY, TO TRANSFER     )  
FUNCTIONAL CONTROL OF     )  
TRANSMISSION FACILITIES LOCATED     )  
IN KENTUCKY TO PJM     )  
INTERCONNECTION, L.L.C. PURSUANT)   
TO KRS 278.218     )

Case No. 2002-00475

**RECEIVED**

AUG 06 2003

PUBLIC SERVICE  
COMMISSION

**PETITION FOR REHEARING  
OF KENTUCKY POWER COMPANY D/B/A  
AMERICAN ELECTRIC POWER**

**I. INTRODUCTION**

Pursuant to KRS 278.400, Kentucky Power Company d/b/a American Electric Power (“Kentucky Power” or “the Company”) seeks rehearing of the Order issued in this case on July 17, 2003 denying Kentucky Power’s application pursuant to KRS 278.218 to transfer functional control of transmission facilities to PJM Interconnection, L.L.C. (“PJM”), a regional transmission organization (“RTO”) approved by the Federal Energy Regulatory Commission (“FERC”).

Kentucky Power and the other AEP operating companies in the AEP East transmission pricing zone (“AEP-East”) are subject to a FERC merger condition and state laws requiring participation in a FERC-approved RTO. Kentucky Power’s share of the projected costs associated with such participation is only \$3 million annually – which represents approximately one percent of its annual revenues from electric service to its retail customers, and would cost a residential electric customer using 1,000 kWh about forty-four cents per month, even assuming,

against all evidence, that there are *no* offsetting reductions from fuel savings or system sales credits.

The Commission says that there has been no demonstration that there are benefits exceeding the costs. However, the only evidence in the record on this subject shows that the benefits to Kentucky Power and the other AEP East operating companies of participating in PJM exceed the costs of such participation. The projected annual cost for all of the AEP East Companies reflected in the record is \$45 million. PJM submitted an analysis showing a range of benefits to the AEP East companies of \$61 million to \$80 million. Moreover, there are additional benefits that are not immediately or readily quantifiable, but are real nonetheless. Such benefits include, but are not limited to, enhanced network reliability<sup>1</sup> and ability to address congestion in the Southeast portion of the AEP system in a comprehensive manner.<sup>2</sup>

The Commission dismissed this evidence because Kentucky Power did not submit an analysis showing how much of the benefit would be allocated to Kentucky Power. The lack of such an operating company-specific cost/benefit analysis played a major part in the Commission's denial of the Company's application. The Commission found that "having readily quantified the cost increases resulting from PJM membership, Kentucky Power is obligated to quantify the benefits of membership."

There are several legal problems with the Commission's finding in this regard. First, the finding that "Kentucky Power is obligated to quantify the benefits of membership" directly conflicts with the Commission's prior interpretation of the type of analysis needed to satisfy the "public interest" standard applied in the instant case. In the *Kentucky American Water Company* case, quoted by the Commission at page 2 of its Order, the Commission held that to meet the

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<sup>1</sup> Direct testimony of J. Craig Baker, at 11; direct testimony of Robert O. Hinkle, at 12.

<sup>2</sup> J. Craig Baker testimony, at 7-8.

public interest standard, a utility must show benefits, but added that “Such benefits *need not be immediate or quantifiable.*” (*emphasis added*).<sup>3</sup> As the Commission itself has recognized, “a cost benefit analysis is only one of several alternatives that can be used in evaluating alternatives.”<sup>4</sup>

Second, there is no requirement for a cost-benefit analysis in KRS 278.218, which was recently amended to require the approval sought in this case. By contrast, the Virginia Legislature, in its recently-enacted legislation requiring state approval of RTO participation, explicitly requires a cost-benefit analysis. The Franklin Circuit Court has recently cautioned against reading a requirement for a cost-benefit analysis into a statute that contains no such requirement.<sup>5</sup> The Court said:

The PSC disallowed Kentucky Power’s costs associated with the low NOx burners because Kentucky Power did not perform a cost/benefit analysis or an evaluation of available compliance options. See May 27, 1997 Order at p. 7. July 8, 1997 Order at p. 3. The PSC erred as a matter of law in denying these costs on this basis.

The only standard for an implementation of the environmental surcharge set forth in KRS 278.183 is that the utility demonstrate that a particular compliance cost is “reasonable and cost-effective.” The statute does not mandate that a utility must demonstrate that a project cost is ‘reasonable and cost-effective’ by performing a cost/benefit study and options analysis. The PSC may not impose such an evidentiary standard in the absence of a statute or regulation establishing cost/benefit studies and options analyses as the only methods by which the utility’s request can be judged.

By reading an absolute requirement for a cost benefit study and an options analysis into the statute, the PSC has violated the basic

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<sup>3</sup> Case No. 2002-00018, Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GMBH, Order dated May 30, 2002.

<sup>4</sup> The Application of Kentucky Power d/b/a American Electric Power for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend its Environmental Cost Recovery Surcharge Tariff, Case No. 2002-00169, Order, March 31, 2003.

<sup>5</sup> *Commonwealth of Kentucky ex rel. Chandler v. Kentucky Pub. Serv. Comm’n, et al.*, Franklin Circuit Ct. Nos. 97-CI-1144, *et al.*, Opinion and Order, April 30, 1998, at 7-8. The Commission appealed the Franklin Circuit Court’s decision to the Kentucky Court of Appeals, and the matter was thereafter disposed of by settlement.

principle that it is unlawful for an agency to interpret a statute so as to add restrictive language when such language does not otherwise exist in the statute. See Bailey v. Reeves, Ky., 662 S.W.2d 832 (1984). Further, the PSC has violated KRS Chapter 13A which prohibits an administrative agency from establishing conditions by internal policy and not by regulation. See KRS 13A.130(1).

Moreover, basic procedural due process requires that the utility be dealt with fairly, including being given fair notice of the requirements an agency is imposing. See Bunch v. Personnel Board, Ky. App. 719 S.W.2d 8 (1986) (holding that an administrative agency is prohibited from acting in an arbitrary manner by Section 2 of the Kentucky Constitution.) See also, Bourbon County Bd. of Adjustment v. Currans, Ky. App., 873 S.W.2d 836, 838 (1994). In this matter, the PSC did not give Kentucky Power notice of its unwritten requirement until it was too late for the utility to comply even if it could otherwise be required to.

The same considerations apply here. In fact, if a cost/benefit requirement cannot be read into a statute requiring a demonstration that a proposal is “reasonable and cost effective”, it is even more doubtful that it can be required given the more general standard applicable to this case (i.e. that the proposal is for a proper purpose and consistent with the public interest).

Finally, a requirement for an operating company-specific showing of net benefits ignores the character of the AEP system as an integrated system. AEP is required by the FERC and several of the AEP-East states to transfer functional control of its East transmission facilities to an RTO. AEP must do what is beneficial for the system companies as a group, even if the benefits, taken in isolation, are unevenly distributed among the operating companies (although there is no evidence that that is the case here). The operating companies, and their customers, enjoy substantial benefits overall as a result of their membership in the integrated AEP System. It is thus unreasonable for the Commission to analyze individual aspects of system membership on an isolated, company-specific basis.

## II. FACTUAL ERRORS

As indicated above, there is no evidence on the record supporting the Commission's denial of Kentucky Power's application. The Commission nevertheless made several factual determinations to support its denial. A number of these findings are unsupported by any evidence, or are contrary to the evidence of record. For example:

1. The Commission found that AEP "voluntarily agreed to [RTO] membership (Order, p. 13). But the evidence shows that FERC's order approving AEP's merger with the former Central and South West (CSW) system required such merger participation.<sup>6</sup> AEP did enter into a stipulation with the FERC Staff in the merger proceeding agreeing to participate in an RTO, but since FERC's clear policy was to require such a commitment as a condition of merger approval, such action cannot reasonably be regarded as "voluntary" in any meaningful sense unless one contends that AEP should have foregone its merger.<sup>7</sup> But the merger was a lawful activity approved by FERC and by this Commission. The Commission did not express any reservation about the RTO condition, either in its order approving the merger or in the FERC proceeding.
2. The Commission found that "[N]either Kentucky Power nor AEP East performed any type of analysis to support its decision to join PJM." (Order, P. 14, *emphasis in original*). That is simply not true. AEP did perform an analysis and it is included in the record.<sup>8</sup> The Commission may be dissatisfied with the analysis, or believe that a different type of analysis should have been done, but it cannot support its finding that no analysis was performed.

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<sup>6</sup> Tr. 64, See also Kentucky Power's Responses to Staff Data Requests, First Set, Item No. 15.

<sup>7</sup> Tr. 65.

<sup>8</sup> Kentucky Power' Response to Staff Data Requests, First Set, Item No. 1.

3. AEP testified that congestion management costs should not be significant.<sup>9</sup> PJM's analysis projected congestion costs to be more than offset by financial transmission rights.<sup>10</sup> The Commission's Order dismisses this evidence because it fails to recognize or even consider "the transmission flows and redispatch that may occur under PJM." (Order, p. 16). However, there is *no* evidence contradicting AEP's and PJM's evidence on this point, and *no* evidence that there would be any changes in transmission flows or redispatch under PJM that would cause any unhedged congestion costs.
4. The Commission found that "the record demonstrates that Kentucky Power will receive minimal, if any, benefits from joining PJM." (Order, p. 18) In other words, the Commission has found that little or none of the net benefits quantified by PJM would be allocated to Kentucky. Again, there is simply no evidence to support this finding. The Commission's citations to the record in support of this finding include PJM's witness' testimony on cross examination that he did not know how costs and benefits are allocated to the operating companies under the AEP pool agreement<sup>11</sup>, that the Company did not perform an analysis suggested by the Commission staff, and that the PJM expert witness could not understand how such an analysis could be done, given the lack of pertinent data.<sup>12</sup> Significantly, none of this evidence remotely supports the conclusion that Kentucky Power will receive little or none of the benefits of PJM membership.

5. The Commission found that Kentucky Power customers will not benefit from

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<sup>9</sup> Tr. 11.

<sup>10</sup> Attachment A to Ott Testimony, p. 11.

<sup>11</sup> Tr. 178-179.

<sup>12</sup> Tr. 149-151.

PJM's markets because the Company meets its load with its own generation (Order, pp. 17-18). However, this ignores that Kentucky Power shares in system sales profits which, in part, reduce customers' fuel charges.

6. The Commission found that the testimony that participation in PJM will enhance reliability "Stands in stark contrast to Kentucky Power' admission that there have been no specific instances of unreliable transmission service to native load customers in the past 3 years" (Order, p. 15). Evidence that reliability will be enhanced does not in any way conflict with evidence that there has been no major transmission reliability failure (i.e., one that disrupted service to native load) in the last three years. More to the point, it does not follow, as implied, that enhancement of reliability is unnecessary because there have been no recent catastrophic failures. That is like saying that it doesn't make sense to spend money on airline safety because there hasn't been a crash in a while.
7. The Commission found that if it approves the proposed transfer, the Commission would have "to acquiesce in violation of a law we are required to enforce." (Order, pp. 20-21). Here the Commission is referring to KRS 278.214 which requires Kentucky firm native load customers to be curtailed last in any transmission emergency. However, the conflict between federal and state law on this point exists irrespective of whether or not AEP joins PJM. The federal provisions that conflict with KRS 278.214 are contained in FERC's pro-forma open access transmission tariff, and therefore are in AEP's existing tariff as well as PJM's tariff. In fact, the presence of such provisions in AEP's existing tariff is the subject of a civil action in federal district court.

### III. REQUEST TO REOPEN RECORD

The above discussion does not exhaust the legal and factual errors in the Commission's Order. Moreover, there is an underlying question of federal preemption that some parties are currently pressing at FERC. At this stage, however, Kentucky Power does not believe that it is productive to get into detailed arguments about such legal and factual issues. The Commission's denial of Kentucky Power's participation in PJM places the Company in an awkward position of being subject to conflicting federal and state orders. As AEP has told the FERC, it is in no one's best interest -- the Company, its regulators, and, most important, its customers -- to become embroiled in costly and time-consuming litigation over such conflicts. Kentucky Power would much prefer to have an opportunity to persuade its state regulators that its course of action is beneficial to customers. The Company is disappointed that it was unable to do so in this case, considering that the *only* evidence submitted in this case supports approval of the Company's application for Commission approval of its participation in PJM, and *no* evidence was submitted in favor of denial.

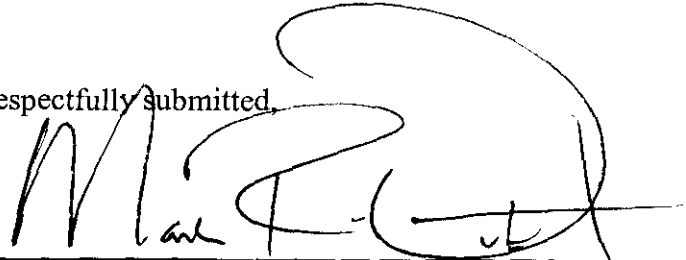
Therefore, while not specifically required by KRS 278.218, Kentucky Power is willing to present company-specific cost benefit information. The Company therefore requests rehearing for the purpose of the submission and consideration of such information. Allowing the hearing to be reopened for this limited purpose would avoid the due process issue discussed by the Franklin Circuit Court in the *Kentucky ex rel. Chandler* case discussed *supra*. Moreover, the delay occasioned by the Virginia legislation and the pendency of this and other proceedings provides sufficient time for the consideration of such additional evidence. When it first submitted its case in December, 2002, The Company anticipated PJM membership beginning in February, 2003, and therefore believed it was on an expedited timetable for state approval. At



this point, however, AEP does not anticipate that it will be in a position to transfer functional control of its facilities to PJM until some time in 2004. Moreover, the fact that the Commission has, in a companion order in Case No. 2003-00266, directed Louisville Gas and Electric and Kentucky Utilities to submit cost-benefit analyses supporting their continued participation in the Midwest ISO, indicates that the Commission will have an opportunity to consider on a comprehensive basis the appropriate parameters of such an analysis. AEP is in the process of developing cost-benefit information in light of the explicit Virginia requirement discussed above. AEP could, once such information is available, adapt such information to Kentucky.

WHEREFORE, Kentucky Power requests rehearing of the Commission's order as discussed in this Petition.

Respectfully submitted,



Mark R. Overstreet  
STITES & HARBISON, PLLC  
421 West Main Street  
P.O. Box 634  
Frankfort, Kentucky 40602-0634  
Telephone: (502) 223-3477  
[moverstreet@stites.com](mailto:moverstreet@stites.com)

COUNSEL FOR KENTUCKY POWER  
COMPANY D/B/A AMERICAN  
ELECTRIC POWER

**CERTIFICATE OF SERVICE**

I hereby certify that a true and accurate copy of the foregoing Petition for Rehearing of Kentucky Power Company d/b/a American Electric Power was served by Regular U.S. Mail, postage prepaid on the 6<sup>th</sup> day of August, 2003 upon:


Elizabeth E. Blackford  
Assistant Attorney General  
Office of Rate Intervention  
1024 Capital Center Drive  
Frankfort, Kentucky 40601

Richard G. Raff  
Public Service Commission of Kentucky  
211 Sower Boulevard  
Frankfort, Kentucky 40601

Brent L. Caldwell  
McBrayer, McGinnis, Leslie & Kirkland, PLLC  
201 East Main Street  
Suite 1000  
Lexington, Kentucky 40507

David F. Boehm  
Michael L. Kurtz  
Boehm, Kurtz & Lowry  
2110 CBLD Center  
36 East Seventh Street  
Cincinnati, Ohio 45202

M. Bryan Little  
Senior Counsel  
PJM Interconnection, L.L.C.  
1200 G. Street N.W. Suite 841  
Washington, D.C. 20005

A handwritten signature in black ink, appearing to read 'Mark R. Overstreet', written over a horizontal line.

Mark R. Overstreet